

to the satisfaction of the Commissioner, then the aggregate of the “excludable portions” in respect of the entire parcel shall be allocated to each portion in proportion to the fair market value of each at the time of the disposition.

(b) *Instances of nonapplication*—(1) *In general.* Section 1255 does not apply if a taxpayer disposes of section 126 property more than 20 years after receipt of the last section 126 payment with respect to the property.

(2) *Losses.* Section 1255(a)(1) does not apply to losses. Thus, section 1255(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is section 126 property, nor does the section apply to a disposition of the property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of the property is not greater than its adjusted basis.

(c) *Relation of section 1255 to other provisions*—(1) *General.* The provisions of section 1255 apply notwithstanding any other provisions of Subtitle A of the Code except that they do not apply to the extent gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. Thus, unless an exception or limitation under § 16A.1255-2 applies, gain under section 1255(a)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1255 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1255 upon a disposition of section 126 property will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of property to which section 1231 applies. See example (1) of paragraph (d) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition of gain provisions of Subtitle A of the Code which section 1255 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, and 512(b)(5). See § 16A.1255-2 for the extent to which section 1255(a)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, and 1033.

(3) *Installment method.* Gain from a disposition to which section 1255(a)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such a case, the portion of the installment payment that is gain is treated as follows: first as ordinary gain under other sections of Chapter I Subchapter P, Part IV of the Code until all that gain has been reported; next as ordinary gain to which section 1255 applies until all that gain is reported; and finally as gain under other sections of Chapter I, Subchapter D, Part IV of the Code. For treatment of amounts as interest on certain deferred payments, see section 483.

(4) *Exempt income.* With regard to exempt income, the principles of § 1.1245-6(e) shall be applicable.

(5) *Treatment of gain not recognized under section 1255(a)(1).* For treatment of gain not recognized under this section, the principles of § 1.1245-6(f) shall be applicable.

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. Individual A uses the calendar year as his taxable year. On April 10, 1995, A sells for \$75,000 section 126 property with an adjusted basis of \$52,500 for a realized gain of \$22,500. The excludable portion under section 126 was \$18,000. A received the section 126 payment on January 5, 1990. No gain is recognized as ordinary gain under sections 1231 through 1254. Because the applicable percentage, 100 percent, of the aggregate of the section 126 improvements (\$18,000), \$18,000, is lower than the gain realized, \$22,500, the amount of gain recognized as ordinary income under section 1255(a)(1) is \$18,000. The remaining \$4,500 of the gain may be treated as gain from the sale or exchange of property described in section 1231.

§ 16A.1255-2 Special rules.

(a) *Exception for gifts*—(1) *General rule.* In general, no gain shall be recognized under section 1255(a)(1) upon a disposition of section 126 property by gift. For purposes of section 1255 and this paragraph, the term “gift” shall have the same meaning as in § 1.1245-4(a) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245-4(a)(2) shall apply.

(2) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of section 126 property is in part a sale or exchange and in part a gift, the amount of gain which shall be recognized as ordinary income under section 1255(a)(1) shall be computed under § 16A.1255-1(a)(1), applied by treating the gain realized (for purposes of § 16A.1255-1(a)(1)(ii)), as the excess of the amount realized over the adjusted basis of the section 126 property.

(3) *Treatment of section 126 property in hands of transferee.* See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On March 2, 1986, A makes a gift to B of a parcel of land having an adjusted basis of \$40,000 and fair market value of \$65,000. On the date of that gift, the aggregate of excludable portions under section 126 was \$24,000. The section 126 payments were all received on January 15, 1981. Upon making the gift, A recognizes no gain under section 1255(a)(1). See paragraph (a)(1) of this section. For treatment of the property in the hands of B, see example (1) of paragraph (d)(3) of this section.

Example (2). (i) Assume the same facts as in example (1), except that A transfers the land to B for \$50,000. Assume further that no gain is recognized as ordinary income under any other provision of Chapter I, Subchapter P, Part IV of the Code. Thus, the gain realized is \$10,000 (amount realized, \$50,000, minus adjusted basis, \$40,000), and A has made a gift of \$15,000 (fair market value, \$65,000, minus amount realized, \$50,000).

(ii) Upon the transfer of the land to B, A recognizes \$10,000 as ordinary income under section 1255(a)(1), computed under paragraph (a)(2) of this section as follows:

(1) Aggregate of excludable portions under section 126	\$24,000
(2) Multiply: Applicable percentage for land disposed if within sixth year after section 126 payments were received	100
(3) Amount in § 16A.1255-1(a)(1)(i)	\$24,000
(4) Gain realized (see (i) of this example)	10,000
(5) Amount in § 16A.1255-1(a)(1)(ii) applied in accordance with paragraph (a)(2) of this section	10,000
(6) Lower of line (3) or line (5)	10,000

Thus, the entire gain realized on the transfer, \$10,000, is recognized as ordinary income.

For treatment of the farm land in the hands of B, see example (2) of paragraph (d)(3) of this section.

(b) *Exception for transfer at death—(1) In general.* Except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1255(a)(1) upon a transfer at death. For purposes of section 1255 and this paragraph, the term “transfer at death” shall have the same meaning as in § 1.1245-4(b) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245-4(b)(2) shall apply.

(2) *Treatment of section 126 property in hands of transferee.* If, as of the date a person acquires section 126 property from a decedent, the person's basis is determined by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death, or on the applicable date provided in section 2032 (relating to alternative valuation date), then on that date the aggregate of excludable portions under section 126 in the hands of such transferee is zero.

(c) *Limitation for certain tax-free transactions—(1) Limitation on amount of gain.* Upon a transfer of section 126 property described in paragraph (c)(2) of this section, the amount of gain recognized as ordinary income under section 1255(a)(1) shall not exceed an amount equal to the excess (if any) of (i) the amount of gain recognized to the transferor on the transfer (determined without regard to section 1255) over (ii) the amount (if any) of gain recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. For purposes of paragraph (c)(1) of this section, the principles of § 1.1245-4(c)(1) shall apply. Thus, in the case of a transfer of section 126 property and other property in one transaction, the amount realized from the disposition of the section 126 property (as determined in a manner consistent with the principles of § 1.1245-1(a)(5)) shall consist of that portion of the fair market value of each property acquired which bears the same ratio to the fair market value of the acquired property as the amount realized from the disposition of the section 126 property bears to the total amount realized. The preceding sentence shall be applied solely for purposes of computing the portion of the

total gain (determined without regard to section 1255) which is eligible to be recognized as ordinary income under section 1255(a)(1). The provisions of this paragraph do not apply to a disposition of property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by Chapter I of the Code.

(2) *Transfers covered.* The transfers referred to in paragraph (c)(1) of this section are transfers of section 126 property in which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(i) Section 332 (relating to distributions in complete liquidation of an 80-percent-or-more controlled subsidiary corporation). For application of paragraph (c)(1) of this section to such a complete liquidation, the principles of § 1.1245-4(c)(3) shall apply. Thus, for example, the provisions of paragraph (c)(1) of this section do not apply to a liquidating distribution of section 126 property by an 80-percent-or-more controlled subsidiary to its parent if the parent's basis for the property is determined, under section 334(b)(2), by reference to its basis for the stock of the subsidiary.

(ii) Section 351 (relating to transfer to a corporation controlled by the transferor).

(iii) Section 361 (relating to exchanges pursuant to certain corporate reorganizations).

(iv) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(v) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(vi) Section 721 (relating to transfers to a partnership in exchange for a partnership interest). See paragraph (e) of this section.

(vii) Section 731 (relating to distributions by a partnership to a partner). For special carryover of basis rule, see paragraph (e) of this section.

(viii) Section 1031 (relating to like kind exchanges).

(ix) Section 1034 (relating to rollover of gain on the sale of a principal residence).

(3) *Treatment of section 126 property in the hands of transferee.* See paragraph (d) of this section for treatment of the transferee in the case of a disposition to which this paragraph applies.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On January 4, 1986, A holds a parcel of property that is section 126 property having an adjusted basis of \$15,000 and a fair market value of \$40,000. On that date he transfers the parcel to corporation M in exchange for stock in the corporation worth \$40,000 in a transaction qualifying under section 351. On the date of the transfer, the aggregate of excludable portions under section 126 with respect to the transferred property is \$18,000 and all of such amount was received on March 25, 1981. With regard to section 1255, A would recognize no gain under section 351 upon the transfer and M's basis for the land would be determined under section 362(a) by reference to its basis in the hands of A. Thus, as a result of the disposition, no gain is recognized as ordinary income under section 1255 by A since the amount of gain recognized under that section is limited to the amount of gain which is recognized under section 351 (determined without regard to section 1255). See paragraph (c)(1) of this section. For treatment of the section 126 property in the hands of B, see paragraph (d)(1) of this section.

Example (2). Assume the same facts in example (1), except that A transferred the property to M for stock in the corporation worth \$32,000 and \$8,000 cash. The gain realized is \$25,000 (amount realized, \$40,000, minus adjusted basis, \$15,000). Without regard to section 1255, A would recognize \$8,000 of gain under section 351(b). Assume further that no gain is recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code. Therefore, since the applicable percentage, 100 percent of the aggregate excludable portions under section 126, \$18,000, is lower than the gain realized, \$25,000, the amount of gain to be recognized as ordinary income under section 1255(a)(1) would be \$18,000 if the provisions of paragraph (c)(1) of this section do not apply. Since under section 351(b) gain in the amount of \$8,000 would be recognized to the transferor without regard to section 1255, the limitation provided in paragraph (c)(1) of this section limits the gain taken into account by A under section 1255(a)(1) to \$8,000.

Example (3). Assume the same facts as in example (2), except that \$5,000 of gain is recognized as ordinary income under section 1251(c)(1). The amount of gain recognized as ordinary income under section 1255(a)(1) is \$3,000 computed as follows:

(1) Amount of gain under section 1255(a)(1) (determined without regard to paragraph (c)(1) of this section):	
(a) Aggregate of excludable portions under section 126	\$18,000
(b) Multiply: Applicable percentage for property disposed of within the fifth year after section 126 payments were received (percent)	100
(c) Amount in § 16A.1255-1(a)(1)(i)	\$18,000
(d) Gain realized (amount realized \$40,000 less adjusted basis, \$15,000)	\$25,000
(e) Lower of line (c) or line (d)	\$18,000
(2) Limitation in paragraph (c)(1) of this section:	
(a) Gain recognized (determined without regard to section 1255)	\$8,000
(b) Minus: Gain recognized as ordinary income under section 1251(c)(1)	\$5,000
(c) Difference	\$3,000
(3) Lower of line (1)(e) or line (2)(c)	\$3,000

Thus, the entire gain recognized under section 351(b) (determined without regard to sections 1251 and 1255), \$8,000, is recognized as ordinary income since that amount is equal to the sum of the gain recognized as ordinary income under section 1251(c)(1), \$5,000, and under section 1255(a)(1), \$3,000.

(d) *Treatment of section 126 property received by a transferee in a disposition by gift and certain tax-free transactions—(1) General rule.* If section 126 property is disposed of in a transaction which is either a gift to which paragraph (a)(1) of this section applies, or a completely tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of section 1255—

(i) The aggregate of the excludable portions under section 126 in respect of the land in the hands of the transferee immediately after the disposition shall be an amount equal to the amount of such aggregate in the hands of the transferor immediately before the disposition, and

(ii) For purposes of applying section 1255 upon a subsequent disposition by the transferee (including a computation of the applicable percentage), the dates of receipt of section 126 payments shall not be affected by the dispositions.

(2) *Certain partially tax-free transfers.* If section 126 property is disposed of in a transaction which either is in part a sale or exchange and in part a gift to which paragraph (a)(2) of this section applies, or is a partially tax-free transfer to which paragraph (c)(1) of this section applies, then for purposes of

section 1255 the amount determined under paragraph (d)(1) of this section shall be reduced by the amount of gain taken into account under section 1255 by the transferor upon the disposition. Upon a subsequent disposition by the transferee, the dates of receipt of section 126 payments remain the same in the hands of the transferee as they were in the hands of the transferor. With respect to the 175 and 182 deductions taken by the transferee, the holding period shall not include the holding period of the transferor.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). Assume the same facts as in example (1) of paragraph (a)(4) of this section. Therefore, on the date B receives the land in the gift transaction, under paragraph (d)(1) of this section the aggregate of excludable portions under section 126 in respect of the land in the hands of B is the amount in the hands of A, \$24,000, and for purposes of applying section 1255 upon a subsequent disposition by B (including a computation of the applicable percentage) the date the section 126 payments were received is the same as it was when the property was in A's hands (January 15, 1981).

Example (2). Assume the same facts as in example (2) of paragraph (a)(4) of this section. Under paragraph (d)(2) of this section, the aggregate of excludable portions under section 126 which pass over to B for purposes of section 1255 is \$14,000 (\$24,000 excluded under section 126 minus \$10,000 gain recognized under section 1255(d)(1) in accordance with example (2) of paragraph (a)(4) of this section). The date the section 126 payments were received is the same as when the property was in B's hands (January 15, 1981).

(e) *Disposition of section 126 property not specifically covered.* If section 126 property is disposed of in a transaction not specifically covered under § 16A.1255-1, and this section, then the principles of section 1245 shall apply.

PART 17—TEMPORARY INCOME TAX REGULATIONS UNDER 26 U.S.C. 103(c)

AUTHORITY: Sec. 7805 of the Internal Revenue Code of 1954; 68A Stat. 917 (26 U.S.C. 7805).